City of Hemet

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CITY MANAGER

May 16, 2008

Mr. Robert Grossman
Group Managing Director
U.S. Public Finance
Fitch Ratings
33 Whitehall Street 27th fl.
New York, NY 10004

Ms. Gail Sussman
Group Managing Director
Public Finance
Moody's Investors Service
250 Greenwich Street
New York, NY 10007

Mr. William Montrone
Head
U.S. Public Finance
Standard & Poor's
55 Water Street
New York, NY 10041

Subject: Ending Double Standard in Ratings of Municipal and Corporate Bonds

Dear Mr. Grossman, Ms. Sussman and Mr. Montrone,

The current system of assigning credit ratings to bonds issued by governmental entities which provide essential services to the public leads to indefensible market discrimination against state and local municipal issuers. The rating agencies' own studies show that the likelihood of default by municipal borrowers is much lower than for corporate borrowers with similar ratings. Ratings should be based primarily on an evaluation of the likelihood investors will suffer a loss due to default. Unfortunately, for municipal bonds, they are not. This practice costs taxpayers enormous amounts of money that could be invested in public programs and infrastructure.

The City Council of City of Hemet recently adopted a resolution (copy enclosed), urging your companies to end the double standard in the treatment of municipal and corporate bonds. The City Council urges you to treat taxpayers the same as corporations and rate municipal bonds based on the risk investor loss due to default. Finally, we urge you to do this by creating a unified, global rating approach that treats all issuers equally, thereby better serving taxpayers and investors.

Thank you.

Len Wood,
Interim City Manager

Laura M. Nomura
Finance Director

cc. CA State Treasurer

CITY OF HEMET
Hemet, California
RESOLUTION NO. 4208

A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF HEMET, CALIFORNIA, SUPPORTING REFORM OF THE BOND RATING SYSTEM TO ELIMINATE DISCRIMINATION AGAINST MUNICIPAL BONDS.

WHEREAS, the recent turmoil in the municipal bond markets has brought into focus the higher standards imposed by the three major bond rating agencies in rating municipal bonds compared to corporate bonds, mortgage-backed securities and other debt instruments; and

WHEREAS, issuers of municipal bonds rarely default on the bonds they sell to finance streets and roads, public buildings, bridges, flood protection and water systems, and other critical infrastructure, yet municipal bond ratings fail to reflect that fundamental fact; and

WHEREAS, the rating agencies even acknowledge this disparity, but they ignore it in their ratings. Standard & Poor's, for example, acknowledges that the historic rate of defaults of A-rated municipal bonds is 0.23 percent, while that of corporate bonds is 2.91 percent - or 13 times greater; and

WHEREAS, despite the relative default rates shown by their own data, the rating agencies continue to discriminate against municipal issuers, requiring public agencies to secure expensive bond insurance in order to secure bond ratings comparable to those of private corporations; and

WHEREAS, the rating agencies base their ratings of corporate bonds on the risk the issuer will default. Their ratings of municipal bonds, in contrast, have little relationship to the risk of default. This difference provides a substantial economic benefit at the expense of taxpayers across the nation; and

WHEREAS, a coalition of state and local public agencies, led by California State Treasurer Bill Lockyer, has called on the three major rating agencies to examine their practices and treat municipal bonds on par with corporate bonds that expose investors to the same level of risk. The Treasurer also testified before the House Financial Services Committee on March 12 about the need for reform.

WHEREAS, the response by the rating agencies to the call for reform has been uneven. Moody's has taken the greatest strides, announcing it will assign a corporate-equivalency rating (what it calls a global scale rating or GSR) alongside the traditional municipal rating to any municipal bond at the issuer's request; and

WHEREAS, the current double-standard by rating agencies: (1) drains billions of dollars from taxpayers' pockets in the form of unfairly high interest rates; (2) forces taxpayers to pay even more money to buy bond insurance – insurance they would not have to purchase if municipal bond ratings accurately reflected the slight risk of default; (3) misleads investors by grossly inflating the risk of buying municipal bonds; and (4) undermines the effective functioning of a transparent market.

NOW, THEREFORE, the City Council of the City of Hemet does resolve as follows:

That it calls on the major municipal bond agencies to end the double standard in the treatment of municipal and corporate bonds; to treat taxpayers the same as corporations and rate municipal bonds based on the risk of default; and to create a unified, global rating approach that treats all issuers equally, and better serves taxpayers and investors.

RESOLVED FURTHER, that the city manager/finance officer is hereby directed to notify the municipal bond rating agencies by letter of the adoption of this resolution, with a copy to California State Treasurer Bill Lockyer and to register the City as a member of the coalition of public agencies supporting the nationwide effort to reform how bond rating agencies grade state and local bonds.

PASSED, APPROVED, AND ADOPTED this 13th day of May, 2008.

Marc Searl

Marc Searl, Mayor

ATTEST:

Stephen B. Clayton

Stephen B. Clayton, City Clerk

APPROVED AS TO FORM:

Eric S. Vail, City Attorney

State of California)
County of Riverside)
City of Hemet)

I, Sarah McComas, Deputy City Clerk of the City of Hemet, do hereby certify that the foregoing Resolution is the actual Resolution adopted by the City Council of the City of Hemet and was passed at a regular meeting of the City Council on the 13th day of May, 2008 by the following vote:

AYES: Council Members Lowe, McBride and VanArsdale, Vice Mayor Christie and Mayor Searl

NOES:

ABSTAIN:

ABSENT:

Sarah McComas

Sarah McComas, Deputy City Clerk